

Before the  
Federal Communications Commission  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
DA 96-45  
OFFICE OF SECRETARY

In the Matter of

Notice of Proposed Rulemaking  
and Order Establishing Joint Board  
on Universal Service

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CC Docket 96-45

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Comments of Cathey, Hutton and Associates

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## SUMMARY

Cathey, Hutton and Associates (CHA) submits its responses to certain questions raised in this proceeding by the Joint Board regarding universal service. CHA is a full service consulting firm representing small and rural telephone companies across the Nation. CHA generally supports the responses to be filed by the Rural Telephone Coalition (RTC) and submits its responses only to emphasize certain issues in addition to those raised by the RTC.

CHA urges the Joint Board and the Commission to implement Section 254 of the Telecommunications Act of 1996 in a manner which assures all subscribers to all local exchange carriers (LECs) an opportunity to enjoy the benefits intended by the legislation. In the short period of time allowed to create a competitively neutral marketplace, CHA respectfully reminds the Joint Board and the Commission that Section 254 contains plain language protecting and advancing universal service goals and ideals which must be supported by the detailed policy to be implemented. New rules are not required, only rules which support the law. Much of current rules will support the new law. The record is rich in support of the accomplishments of small and rural LECs providing high quality universal service made possible under existing policy and which is to be continued and enhanced under the new law..

Section 254 addresses issues beyond simply high cost areas as was the case under the law before 1996.. Section 254 mandates rates that are affordable, reasonable and comparable across the country, urban or rural, high cost or low cost. Section 254 mandates federally sourced revenues sufficient to achieve those goals. Sponsors of proxy models do not believe their theories and equations accurately reflect, or even approximately reflect, the diverse cost characteristics of rural America served by small companies. To the extent large companies serve rural areas, they retain the advantages of their size, combined with market power to absorb the losses a proxy model may produce. Small companies do not enjoy this substantial advantage. Small companies rely to a substantially greater extent upon universal service revenues compared to price cap LECs. Sudden or substantial disruptions to these revenues will seriously jeopardize their ability to continue to provide universal services in compliance with the Act.

At a minimum, the Joint Board and Commission should adopt a wait-and-see approach to the problems and challenges of implementing substantial changes to the revenue streams of small and rural LECs in its efforts to implement Section 254. Proxy models may aid the Commission in allocating support to smaller areas but must not be relied upon to determine the support itself. Only actual costs can comply with the law.

Finally, CHA filed comments in several phases of CC Docket 80-286 and reply comments in CC Docket 96-45. We outlined a method for calculating universal service support which provides incentives to control costs while continuing to recognize the requirements of the 1996 Act, especially as it relates to small LECs serving rural, insular or high cost areas. We believe it can form the basis for a long term solution to the problems associated with universal service. At a minimum, the proposal provides for maintaining cost based revenues on an interim basis until further experience can be gained from changes to current methods.

Q 1. Is it appropriate to assume that current rates for services included within the definition of universal service are affordable, despite variations among companies and service areas?

A. The answer to this question depends upon the answer to question # 2. By itself, this question could be answered “Yes” since many state commissions have examined the rates of many LECs and have determined those rates to be at least reasonable or in the public interest.

This question could be answered “No” when considering that no state commission has determined the local rates of LECs to be in compliance with the additional standards of universal service required by the 1996 Act.

Finally, it may not be appropriate to assume current rates are affordable when considering the penetration rates among certain classes of customers, e.g. Native Americans. Nor would some local rates be considered “comparable” when comparing the limited calling scopes available to many rural customers with the millions of callers available toll free to urban ratepayers.

Q 2. To what extent should non-rate factors, such as subscribership levels, telephone expenditures as a percentage of income, cost of living, or local calling area size be considered in determining the affordability and reasonable comparability of rates?

A. When legal definitions of terms contained within the 1996 Act, e.g., “affordable”, “reasonable”, “comparable” and “sufficient”, have been determined, measures to “score” retail rates charged for universal services against the legal standards may be developed. It is reasonable to assume this “scoring” system could be a formal and empirical process that could produce a range of rates presumed reasonable, comparable and affordable for a set of circumstances that could include regional factors such as income and / or calling scopes.

Q 3. When making the “affordability” determination required by Section 254 (i) of the Act, what are the advantages and disadvantages of using a specific national benchmark rate for core services in a proxy model?

A. First, this question need not be limited to proxy models. The current Part 36 procedures used to allocate loop costs (25% BAF plus USF) combine to establish a de facto benchmark of intrastate cost recovery at approximately \$18.50 per loop per month. This benchmark is based upon actual reported costs.

Whether the universal service cost is based upon reported, actual costs or is proxy-based, when combined with the requirements of the act discussed in our responses to the previous questions, it becomes clear that the federal universal service support obligation resulting from the Act contemplates a standard or benchmark rate or range of rates as a measurable target

which supports the “reasonable and comparable” standard. The primary advantage to a benchmark figure is that it is unambiguous and therefore easily measured and identified as a standard and provides a clear beacon for states to establish rates within their jurisdiction which further support universal service goals.

Q 26. If the existing high cost support mechanisms remain in place (on either a permanent or temporary basis), what modifications, if any, are required to comply with the Telecommunications Act of 1996?

A. Very little change is required for the current universal service support mechanism used to calculate high cost areas to comply with the Act. In order to properly target universal service support to both the high cost areas requiring support and/or the Eligible Telecommunications Carrier (ETC) designees qualifying for support, it may be necessary to calculate support at less than a study area level. If this approach is taken, the Commission should seriously weigh the costs of identifying less than study area support requirements of small study areas compared to the benefit(s) to be gained from the disaggregation of support. The Commission should not disaggregate support to rural LECs unless a bona fide ETC provides service in the rural LECs service area. If this occurs, universal service support should be disaggregated to match the area deemed the standard minimum service area eligible for qualification as an ETC. Irrespective of the geographic area used to determine universal service support, actual reported costs must form the basis for the calculation of the support for both the incumbent and the new entrant.

In addition, the list of entities which provide financial support to a universal service fund requires expansion to include all interstate telecommunications providers, not simply IXC's.

The Act does not permit a cap on the amount of universal service funding.

Finally, in order to meet the “sufficiency” requirements of the Act, costs other than loop may require identification and federal revenue support.

Q 27. If the high cost support system is kept in place for rural areas how should it be modified to target the fund better and consistently with the Telecommunications Act of 1996?

A. Geographic boundaries less than the current “study area” definition may be more appropriate to allocate reported costs to properly target support. This will be critical if an ETC is designated to serve less than a “study area” in rural areas.

Q 28 .What are the potential advantages and disadvantages of basing the payments to competitive carriers on the book costs of the incumbent local exchange carrier operating in the same service area?

A. To the extent any proxy method of cost determination supports the public policy of universal service in high cost areas is open to debate. In the broadest sense, CHA does not believe requiring a proxy method to determine costs complies with the Act. Thus, to the extent a new entrant can utilize a proxy as a substitute for its cost which is based upon the actual cost of the incumbent is also problematic. Having restated our objections to proxy costs in general, we believe it is possible to, initially and for a brief time thereafter, establish an incumbent's universal service support per line as the temporary proxy cost per line in limited geographic areas for a new entrant ETC. In the long run, we believe each ETC must provide its own costs as proof of need to receive universal service support. We do not believe the Act contemplates universal service support as a right of ANY ETC, only those ETCs that demonstrate costs leading to rates in excess of what the Act deems "affordable, reasonable and comparable". In fact, just as is the case today, any support must be based upon actual need, not simply or solely on the basis of some notion of "fairness" or competitive parity. Allowing all ETCs to avail themselves of a support mechanism upon demonstrated proof of need is all the Act requires.

Q 31. If a bifurcated plan that would allow the use of book costs (instead of proxy costs) were used for rural companies, how should rural companies be defined?

A. Pursuant to the Act's definition.

Q 34. What, if any, programs (in addition to those aimed at high cost areas) are needed to insure that insular areas have affordable telephone service?

A. None. If the insular area demonstrates high costs, it will qualify for support. In the alternative, supposing changes to the current mechanisms of universal service support, if an insular area's rates exceed any benchmark established as "affordable", it would also qualify for support.

Q 37. How does a proxy model determine costs for providing only the defined universal service core services?

A. Any model, like any cost allocation method, will reflect the opinion(s) of its designer. Some costs included in a model will, by necessity and definition, be arbitrary, perhaps the result of an allocation of some other joint or common cost. In other cases, a model reflects not the real world but an idealized "model" world where perfection in design and deployment is realized. In this "model" world, the costs for providing core, universal services could potentially be understated or overstated.

Q 40. If a proxy model is used, what, if any, measures are necessary to assure that urban rates and rates in rural, insular and high cost areas are reasonably comparable, as required in Section 254(b)(3) of the 1996 Act?

A. This question must be asked regardless of how costs are determined, whether actual or proxy. This aspect of the Act requires reconciliation of the federal-state jurisdictional tension inherent in this federal requirement aimed at state ratemaking authority. An easy answer is that the Act can be interpreted to provide states with the resources sufficient to provide an opportunity for the comparable rates required by the Act. The Act does not preempt the states' rights to set state rates.

Through the use of the range of rates discussed in response to Question 2, ETCs can report their rates and certify them as in compliance to state regulatory bodies.

Q 42. Will support calculated using a proxy model provide sufficient incentive to support infrastructure development and maintain quality service?

A. The proxy method is a system not based upon actual costs but a system designed to support areas with costs predicted to be higher than average. The current incentive to build networks where they might not have made economic sense, hence making universal support necessary, will disappear. New and different incentives will be the result of a proxy system of high cost support. For example, high cost support independent of management decisions, part of the appeal of supporting proxy costs over actual costs, yields revenue regardless of infrastructure deployment or maintenance. The price of proxy costs will be the removal of management incentive to invest in the infrastructure, absent competitive pressure to do so. In rural areas, and perhaps in many suburban and urban areas, there may never be more than a single network built. Competitors will simply purchase unbundled or resold network elements from the facility-based incumbent. There may never be the competitive pressure necessary for ubiquitous, or even widespread, deployment of advanced infrastructure to remain competitive.

Q 43. Should there be recourse for companies whose book costs are substantially above the costs projected for them under a proxy model? If so, under what conditions ( for example, at what cost levels above the proxy amount) should carriers be granted a waiver allowing alternative treatment? What standards should be used when considering such requests?

A. The 1996 Act requires universal service support to be "sufficient". This requirement means ETCs which demonstrate qualifying high costs **MUST** be provided federal revenues to meet the "sufficient" requirements of the Act.

This query therefore raises the opposite question relative to a proxy method: What does the law require for companies whose actual costs are substantially below the proxy method's

projected cost? Do these ETCs, whether new entrants or incumbent LECs, forego universal service support revenues? Do they retain the proxy-based universal service support even though they do not need the revenue and, in fact, could use the revenue to support other, competitive services? If adjustments are to be made to the universal service revenues of entities whose costs are above or below the proxy costs, why even subject ETCs to the proxy methods? Providing universal service subsidy to all eligible providers does not require a proxy model to make the program competitively neutral. Simply subjecting all ETC seeking universal service support to the same rules will achieve the competitive neutrality requirements of the Act.

Imposing proxy cost methods upon small and rural LECs risks catastrophic results for these entities which have the most at risk in the provision of universal service. These questions seem to indicate the Joint Board is seeking a way to begin the process of universal service reform that will impact the RBOCs and GTE, or perhaps to all price cap carriers while delaying the full implementation of changes to the universal service program for small and rural LECs until some experience is gained under any new program. With the exception of Bell South and GTE, these large carriers do not rely upon USF revenue streams to the extent small and rural LECs do. In concert with access charge reform and after some experience has been gained in the new competitive environment, rural LEC markets can be examined and monitored more carefully to determine if proposed changes to universal service programs will apply in all markets and to all LECs.

CHA believes this is the prudent course to take. CHA also believes the goals of the Act can be achieved initially for rural LECs and subsequent new entrant ETCs utilizing much of the current USF mechanisms but adding features which provide incentives as well as portability while still based upon actual costs.

Q 46. Should a proxy model be adopted if it is based on proprietary data that may not be available for public review?

A. Any information used by the Commission to determine cost recovery required to be "sufficient" must be available to the entity subject to the regulation.

Q 60. The NCTA proposed a number of modifications to the BCM related to switching cost, fill factors, digital loop carrier subscriber equipment, penetration assumptions, deployment of fiber versus copper technology assumptions and service area interface costs. Which, if any, of these changes would be feasible and advisable to incorporate into the BCM?

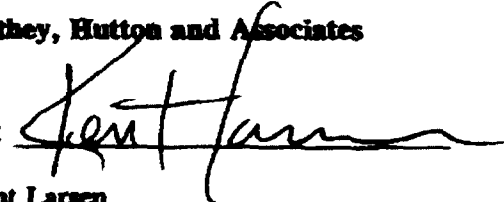
A. Clearly, the quality and quantity of changes to the BCM supported by the NCTA, along with the changes already made by the joint sponsors, combined with the fact that 50% of the original sponsors no longer support the model demonstrates the fatal flaw of any effort to impose proxy methods. If the type of changes suggested by NCTA were proposed in the

interest of accuracy, at the level of detail suggested, ETCs should perform actual cost studies because the difference between a "proxy" cost from a system this complicated is not a proxy study but an actual study.

Respectfully Submitted

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